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## BILL ANALYSIS

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Senate Bill 92 (as introduced 1-26-05)  
Sponsor: Senator Michael D. Bishop  
Committee: Commerce and Labor

Date Completed: 4-12-05

**CONTENT**

**The bill would amend the Income Tax Act to do all of the following:**

- **Allow a taxpayer to claim a credit against the income tax for equity investments in a "qualified business" (focused on technology) or a "community-based seed capital company".**
- **Create the "Michigan Capital Investment Board" to designate qualified businesses and determine the eligibility of community-based seed capital companies, and to distribute tax credits to investors.**
- **Limit the amount of a credit allowed for an investment to 20% of the investor's total investment, subject to a \$50,000 maximum per business; and allow an investor to claim credits for five different investments.**
- **Limit the total of all credits available under the bill to \$10.0 million.**
- **Allow a credit to be claimed under the bill only in a tax year in which the realized return on an investment was less than zero for that tax year.**
- **Require the Board to publish an annual report of its activities and submit the report to the Governor and the Legislature.**

A "qualified business" would be a business that met all of the following criteria:

- Its principal business operations are located in Michigan.
- It has been in operation for three years or less.
- It is not engaged primarily in retail sales, real estate, or the provision of health care or other professional services, but focuses on areas including, but not limited to, alternative energy technology, technology as addressed by the Michigan Tri-Technology Corridor Initiative, and Michigan Life Sciences Corridor Initiative high technology activity.
- It has a preinvestment valuation of \$10.0 million or less.
- It secured total equity or "near equity" financing equal to at least \$250,000 within 24 months after the first date on which equity investments qualifying for credits under the bill were made. ("Near equity" would mean debt that may be converted to equity at the option of the debt holder and royalty agreements.)

The business also would have to meet other criteria that the Board determined would increase the probability of the qualified business's success.

"Community-based seed capital company" would mean a "flow-through entity", the principal business operations of which are located in Michigan, formed solely for the purpose of investing in a single qualified business. "Flow-through entity" would mean an S corporation, partnership, limited partnership, limited liability partnership, or limited liability company,

and would not include a publicly traded partnership that has equity securities registered with the Securities and Exchange Commission.

### Tax Credit

The bill specifies that, for tax years beginning after December 31, 2005, a taxpayer could claim a credit against the income tax for the sum of all of the following:

- The portion of the taxpayer's equity investment in a qualified business.
- The portion of the taxpayer's equity investment in a community-based seed capital company.
- The amount of the equity investment in a community-based seed capital company of a partnership, limited liability company, S corporation, estate, or trust electing to have income taxed directly to the taxpayer based upon the pro rata share of the taxpayer's earnings from the investment of the partnership, limited liability company, S corporation, estate, or trust.

If the amount of the credit allowed for the portion of the taxpayer's equity investment in a qualified business or community-based seed capital company exceeded the taxpayer's tax liability for the tax year, the excess portion of the credit would have to be refunded.

If the amount of the credit allowed for an equity investment in a community-based seed capital company of a partnership, limited liability company, S corporation estate, or trust exceeded the taxpayer's tax liability for the tax year, the excess portion of the credit could not be carried forward or refunded. The excess could be carried forward as an offset to the tax liability in subsequent tax years for 10 tax years or until the excess credit was used up, whichever occurred first. This credit could not be carried back to a tax year before the tax year in which the taxpayer first claimed the credit.

An investment under the bill would be considered to have been made on the same date as the date of acquisition of the equity interest. Investments made before January 1, 2006, would not qualify for a tax credit under the bill.

### Michigan Capital Investment Board

The bill would create the Michigan Capital Investment Board within the Department of Treasury. The Board would have to do all of the following:

- Develop an application process for tax credit certificates for credits allowed under the bill.
- Determine the distribution of tax credits to investors.
- Develop procedures for the qualification and administration of qualified businesses and community-based seed capital companies.
- Develop application forms and distribute copies of them to all community-based seed capital companies and potential individual investors.

For an equity investment to qualify for a credit under the bill, within 100 days of the date of the first investment, the business in which the investment was made would have to notify the Board of the names, addresses, taxpayer identification numbers, shares issued, consideration paid for the shares, and the amount of any credits of all shareholders who initially could qualify for the credits. The list of shareholders would have to be amended as new equity investments were sold or any information on the list changed.

A business would have to apply to the Board to be designated as a qualified business. A qualified business would have to notify the Board, in a timely manner, of any changes in the business's qualifications or in the eligibility of investors to claim a credit under the bill.

A community-based seed capital company would have to apply to the Board for eligibility under the bill. An investment in a community-based seed capital company would qualify for a credit if, in addition to all other requirements under the bill, the Board determined that the following requirements were met:

- The company was a limited partnership or limited liability company and, on or after January 1, 2005, had a total of both capital commitments from investors and investments in qualified businesses of at least \$250,000, but not more than \$10.0 million.
- The company had at least five individual investors who were not affiliates, with no single investor and affiliates of that investor that together owned a total of more than 35% of the ownership interests outstanding in the company.
- The company notified the Board, within 120 days after the date of the first investment, of the names, addresses, taxpayer identification numbers, equity interests issued, consideration paid for the interests, and the amount of any credits under the bill, of all limited partners or members who initially could qualify for the credits, and the earliest year in which the tax credits could be claimed.

The list of limited partners or members who qualified for the credits would have to be amended when new equity interests were sold or when any information on the list changed.

If the Board determined that a business was a qualified business or that an investment in a community-based seed capital company was eligible for a credit, the Board would have to issue a tax credit certificate to be attached to the taxpayer's annual income tax return. The certificate would have to contain the taxpayer's name, address, and tax identification number; the amount of credit; the name of the qualified business or community-based seed capital company; and other information required by the Department of Treasury. A community-based seed capital company would have to notify the Board in a timely manner of any changes in the company's qualifications, the qualifications of any qualified business in which the company had invested, or the eligibility of limited partners or members to redeem the tax credits in any year.

#### Limitations on Tax Credits

The amount of the credit for the portion of a taxpayer's equity investment in a qualified business or community-based seed capital company, other than for an investment of a partnership, limited liability company, S corporation, estate, or trust electing to have income taxed directly to the taxpayer, could not exceed 20% of the taxpayer's total investment. The maximum amount of a credit for investment by an investor in any one qualified business would be \$50,000. For any one year, an investor and all affiliates of the investor could claim credits for up to five different investments in five different qualified businesses.

The amount of a credit for an equity investment in a community-based seed capital company of a partnership, limited liability company, S corporation, estate, or trust electing to have income taxed directly to the taxpayer could not exceed 20% of the taxpayer's total investment and could not exceed a total of \$250,000 in any one qualified business.

A credit under the bill could be claimed only in a tax year in which the realized return on an investment was less than zero for that tax year. ("Realized return" would mean the change in value of the investment that is actually earned over the investment period, including all distributions made during the investment period.)

The total of all credits to all taxpayers for all tax years under the bill could not exceed \$10.0 million. A credit available under the bill would be nontransferable.

The bill specifies that a credit allowed under it could not be claimed for any tax year beginning before January 1, 2008.

If a taxpayer did not claim all of the amount of credit allowed by the taxpayer's tax credit certificate in the first five tax years beginning with the tax year in which the certificate was issued, the certificate would expire and be void, and no further credits could be claimed based on that certificate. In years following the tax year in which a certificate expired, however, the Department of Treasury would have to issue new tax credit certificates for the total amount of tax credits that expired, but the total of all credits for all taxpayers for all years could not exceed the bill's \$10.0 million limitation.

An investor in a community-based seed capital company could claim a credit under the bill only for the investor's investment in that company, and could claim any additional credit for the investor's share of investment in a qualified business made by the community-based seed capital company. An investor in a community-based seed capital company, however, could not claim a credit under the bill for a separate direct investment made by the investor in the same qualified business in which the community-based seed capital company invested.

### Annual Report

By April 1 of each year, the Board would have to publish an annual report of the activities it conducted under the bill and submit the report to the Governor and the Legislature. The report would have to include a list of eligible qualified businesses, a list of eligible community-based seed capital companies, the number of tax credit certificates issued by the Board and the total amount of credits authorized by those certificates, and the total amount of credits claimed under the bill for the immediately preceding calendar year.

Proposed MCL 206.272

Legislative Analyst: Patrick Affholter

### **FISCAL IMPACT**

This bill would reduce income tax revenue by a maximum of \$10.0 million and this loss in income tax revenue would most likely be realized over at least two years beginning in FY 2008-09. All of the \$10.0 million in reduced income tax revenue would affect GF/GP revenue. This bill would not have any direct fiscal impact on local governments.

No cost estimate has been provided by the Department of Treasury regarding its administrative costs under the bill.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.